AP Macroeconomics
Test: What Is Economics?
Instructor's Version

Answers: Free-Response Questions

1. Scarcity and Economic Systems

A. Define scarcity. (3 points)

Scarcity occurs because the quantity of goods and services that people desire exceeds the production possible from existing resources. In other words, wants are unlimited but resources are limited.

either sentence is worth 3 points

B. What are the three questions that every society must face because scarcity exists? (3 points)

What do we produce?
How do we produce it?
Who gets what is produced?

1 point for each

C. Briefly describe the three main categories of economic systems that answer the three questions that arise from scarcity. (6 points)

In a command economy, the answers to the questions above are made by a central planner.

In a traditional economy, the answers come from how things have been done in the past.

In a market economy, prices are used to answer those questions.

1 point for each type, 1 point for each explanation

D. What are the four goals of most economic systems? (4 points)

Most economic systems share four goals in common. These goals are efficiency, price stability, full employment, and growth.

1 point for goal

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E. Explain how economists define capital. What are two types of capital? (4 points)

Economists divide capital into two types: physical capital and human capital. Physical capital includes machinery, buildings, and equipment. Human capital includes the knowledge and skill used to make goods and services, but not natural ability.

2 points for identifying physical and human capital, 1 point for specific examples of physical capital, 1 point for specific examples of human capital

F. How is the price of a good or service determined in a market system? (2 points)

In a market system, the price of a good or service depends on its scarcity. Items with high prices are generally scarcer, and items with low prices are generally less scarce.

1 point for identifying scarcity, 1 point for explanation

G. What is a free good? Give an example of a free good. (2 points)

Free goods are things that people want and can get for free because they're not scarce. Air is a good example. In general, there's enough air for us to breathe without paying for it.

1 point for definition, 1 point for example

2. The Economy and the Government

A. What is a laissez-faire economic policy? (3 points)

This policy has the government stay out of the economy.

B. Adam Smith, a prominent and influential early economist, advocated a laissez-faire policy. He described a phenomenon of market economies, which he called the "invisible hand." What is the invisible hand? (6 points)

When individuals pursue their own self-interest in a market economy, they produce an outcome that creates the greatest net benefit for society. Smith said that it is as if an invisible hand guides people to make choices that are good for society.

Key ideas:
People pursue own self interest: 2 points
Greatest net benefits for society: 2 points
Invisible hand is an illusion, not an actual thing: 2 points

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3. Price as a Rationing Tool

A. How does price ration scarce goods in a market economy? (4 points)

Price discriminates between those who have money and those that do not. Prices allow scarce goods to go to the people who are willing and able to pay for those goods.

either sentence is fine for the full 4 points

B. An increase in price provides information about the relative scarcity of a good. What does it say? (4 points)

An increase in price means a good is relatively scarcer.

C. An increase in price may be caused by either of two things. What are those two things? (4 points)

A good may be more valued than it used to be, and there may be fewer resources available to produce the good.

2 points for one right, 4 points for getting both right

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